No. 18237

United States
Court of Appeals
for the Ninth Circuit.

JEAN RENOIR and DIDO FREIRE RENOIR,

Petitioners,

v

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

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OPINION BELOW

The opinion of the Tax Court of the United States is reported in 37 T. C. 1180.

JURISDICTION

This petition has been filed to review a decision of the Tax Court of the United States involving the income tax liability of petitioners for the taxable years 1956 and 1957.

Notice of deficiency was mailed to petitioners on March 28, 1960 [R. 9, 16], and the petition for redetermination of the deficiency was filed with the Tax Court on June 6, 1960. [R.3] The petition was filed pursuant to § 6213(a) of the Internal Revenue Code of 1954. The decision of The Tax Court was entered on May 31, 1962. [R.4]. Petition for Review was filed and notice thereof served upon counsel for respondent on August 20, 1962. [R.4]

The income tax returns of petitioners for the years 1956 and 1957 were filed with the District Director of Internal Revenue at Los Angeles, California [R. 7.14,16]. The Petition for Review was filed pursuant to § 7483 and jurisdiction is invoked under § 7482 of the Internal Revenue Code of 1954.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and regulations herein involved are set forth in the Appendix, infra.

STATEMENT

The taxes in controversy herein are Federal income taxes for the taxable years ended December 31, 1956 and December 31, 1957. [R. 5,16].

This case was submitted to the Tax Court on a written Stipulation of Facts, [R. 16-18]

Petitioners arrived in France on October 1, 1953 and remained continuously in Europe until July 15, 1956 when they departed France to return to the United States. They were, thus, present in foreign countries for a period in excess of 510 full days, in a period of eighteen (18) consecutive months.

During said period, Jean Renoir (hereinafter referred to as petitioner) performed personal services as a motion picture director and writer in France.

In 1956, petitioner received a salary in the amount of $35,000 in partial payment for personal services performed during said period.

In 1957, petitioner received a salary in the amount of $10,000 in partial payment for personal services rendered during said period.

Petitioners, Jean Renoir and Dido Freire Renoir, are husband and wife and were residents and domiciled in the State of California during all of the years herein referred to.

Petitioners filed their joint Federal Income Tax Returns (Form 1040) for the years 1956 and 1957 with the District Director of Internal Revenue at Los Angeles, California. Said returns were prepared and filed on the cash receipts and disbursements basis.

In said returns so filed petitioners excluded said $35,000 received in 1956 and said $10,000 received in 1957 as being non-taxable under § 911(a)(2) of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Do the words "taxable year" appearing in § 911(a)(2) of the Internal Revenue Code of 1954 mean the year in which the services were performed or the year in which the income attributable to the services performed was received?

2. Is each petitioner entitled to the exclusion provided for in § 911(a)(2), by reason of their being husband and wife domiciled in and residents of the State of California, a community property state?

SPECIFICATIONS OF ERRORS

The Tax Court erred:

[illegible]

cash receipts and disbursements basis.

In [illegible] $25,000 [illegible] in 1955 [illegible]

1957 as being nonrecurrent under § 743(b)(2) of

Internal Revenue Code of 1954.

[illegible]

1. [illegible]

(§ 611(a)(2)) [illegible]

1954 mean the year in which the [illegible]

[illegible]

[illegible] services performed [illegible]

2. [illegible]

also provided that [illegible] § 443(a)(2), [illegible]

[illegible]

[illegible]

property [illegible]

[illegible]

The [illegible]

I.

1. In concluding that the words "taxable year" mean the year in which the income was received;

2. In failing to conclude that the words "taxable year" mean the year in which the services were performed;

3. In failing to conclude that under Regulation 118, § 39.116-1(a) and (b), issued by the Commissioner of Internal Revenue, with the consent of the Treasury Department, which were in effect in 1956 and 1957, until at least, August, 1957, time of receipt of amounts which otherwise qualified under the applicable code sections set out in the Appendix, infra, was immaterial.

II.

In failing to conclude that each petitioner is entitled to such $20,000 exclusion or ratable portion thereof, by reason of their being husband and wife domiciled in and residents of the State of California, a community property state:

(a) Said income earned by reason of the rendition of personal services by Jean Renoir during the period October 1, 1953 to July 15, 1956, was the community income of petitioners earned and owned one-half by each.

+

ARGUMENT

I.

THE WORDS "TAXABLE YEAR" MEAN THE YEAR IN WHICH THE SERVICES WERE PERFORMED AND NOT THE YEAR IN WHICH THE INCOME WAS RECEIVED AND THEREFORE TIME OF RECEIPT IS IMMATERIAL.

This Court in Ladd v Riddell, 309 F. 2d 51, recently held against taxpayers on this point. Petitioners urge this Court to reconsider its views and to reconsider an argument made in the Ladd case but not mentioned in its decision.

In deciding the Ladd case, this Court based its decision solely on the definition of "taxable year" contained in subparagraph (23) of § 7701(a) of the Internal Revenue Code of 1954 and on the Tax Court's decision in the instant case, which decision was likewise bottomed solely on said subparagraph (23).

Neither this Court nor The Tax Court mentions paragraph (a) of said § 7701 which reads:

> Section 7701. Definitions.
>
> (a) When used in this title, when not otherwise distinctly expressed or manifestly incompatible with the intent thereof - (underscoring added).

Clearly the underscored words appearing in (a) above state that the words "taxable year" can have a different meaning than that contained in said subparagraph (23). Such a different meaning is required when distinctly expressed or when said words are so used in a manner

manifestly incompatible with the intent of subparagraph (23).

It is submitted that it is equally clear that the use of the words "taxable year" in § 204 of the Technical Changes Act of 1953, and in § 911 (a)(2) of the Internal Revenue Code of 1954, distinctly expresses a different meaning from that given in subparagraph (23) and that said words as so used are manifestly incompatible with the definition thereof in said subparagraph.

The words "taxable year" appear in said §§ 204 and 911 (a)(2) in the following context:

> "If the 18 month period includes the entire taxable year, the amount excluded under this paragraph for such taxable year shall not exceed $20,000. If the 18 month period does not include the entire taxable year, the amount excluded under this paragraph for such taxable year . . ." shall not exceed the stated ratio. (Underscoring added)

The only "18 month period" referred to in said section is " . . . any period of 18 consecutive months" during which an individual citizen of the United States" is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States . . . . if such amounts constitute earned income . . . . . attributable to such period." (Underscoring added). Manifestly "the 18 month period" used in said limitations provisions must refer back to

"any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, . . .". Therefore, it must follow that the "taxable year" which is included in "the 18 month period" is the taxable year in any period of 18 consecutive months during which an individual citizen of the United States is present in a foreign country or countries during at least 510 full days in such period. Hence, "taxable year" as used in said section means the year during which the services were performed and the income earned.

Congress emphasized its intent that "taxable year" means the year during which the services were performed and the income earned by distinctly expressing what was to be excluded from gross income and exempt from taxation in the following words "amounts received from sources without the United States . . . . if such amounts constitute earned income . . . attributable to such period . . ." (Underscoring added). Thus, Congress plainly and unequivocally stated its intention that amounts attributable to such period are not to be included in gross income and shall be exempt from taxation. The words "attributable to" mean ascribed to or belonging to or pertaining to or due to. [Webster's New International Dictionary, Second Edition; Elmer Reise, 35 T.C. 571]. Thus, the amounts to be excluded from gross income are the amounts which are ascribed to or

belong to or pertain to or due to such period. What period? Such period can only refer back to "any period of 18 consecutive months" during which taxpayer "is present in a foreign country or countries during at least 510 full days in such period. . ." (Underscoring added). It thus appears irrefutable that what is not to be included in income are amounts attributable to the period of 18 consecutive months. And Regulations 111 and 118 so provided in the following language:

> "If attributable to a period of 18 consecutive months in respect of which the citizen qualifies for the exemption from tax thus provided, the amounts shall be excluded from gross income irrespective of when they are received." (Underscoring added) [Reg. 118, § 116-1(b)(1).]

These regulations were in full force and effect when the Internal Revenue Code of 1954 was enacted, thus giving them the full force of law.

The correctness of petitioners' contention is demonstrated by Congressional action in rewriting § 911 in the Revenue Act of 1962. This is the first change made in § 911 since its enactment in the Internal Revenue Code of 1954 and is also the first change made with respect to the subject matter of said section since § 204 of the Technical Changes Act of 1953 amended § 116 (a)(2) of the Internal Revenue Code of 1939.

In rewriting § 911, Congress showed its displeasure with Revenue Ruling 54-72 and Regulations 1.911-1(b)(2)(ii)(c), both of which, in effect, provide that "taxable year" means year of receipt and refused to follow them or to approve them.

Subsection (c)(2) of § 911 of the Revenue Act of 1962 provides "that amounts received shall be considered received in the taxable year in which the services to which the amounts are attributable are performed". [Appendix, infra]. It is submitted, that Congress has shown that its intent has always been that "taxable year" meant the year in which the services were performed and not the year of receipt.

In Evelyn Handcock-Ferguson, 21 T.C.M. Dec. 25, 695 (M), par. 62, 237 P-H Memo TC, the Tax Court again held that "taxable year" means year of receipt. This case is on review to the United States Court of Appeals for the Second Circuit. Par. 56, 337 Prentice Hall Federal Taxes.

II

REGULATIONS 118, § 39.116-1 (a) AND (b) WERE GIVEN THE FORCE OF LAW BY THE ENACTMENT OF § 116 (a)(1) AND (2) OF THE INTERNAL REVENUE CODE OF 1939 AS § 911 (a)(1) AND (2) OF THE INTERNAL REVENUE CODE OF 1954, WITHOUT CHANGE.

The contention herein made under this caption was fully submitted to this Court in the Ladd case, supra.

This Court in its opinion did not mention this contention.

Petitioners herein will not elaborate on this argument as fully as was done in the Ladd case, supra. However, petitioners feel that it should again be brought to this Court's attention, particularly in view of Congress' rewriting § 911 in the Revenue Act of 1962.

The exclusion from gross income for income tax purposes of income earned in a foreign country by a citizen of the United States was contained in the original Internal Revenue Code of 1939 as § 116(a). In general, it provided for such exclusion if the citizen was a bona fide resident of a foreign country or countries.

§ 321 of the Revenue Act of 1951 amended § 116 to provide for an additional such exclusion. (Appendix, infra). This is the so-called "presence abroad" or "eighteen month" exclusion. Said § 321 rewrote said § 116 by making the bona fide resident exclusion § 116(a)(1) and added the presence abroad exclusion as § 116 (a)(2) (Appendix, infra).

Said new paragraph (2) inserted by said § 321 of the Revenue Act of 1951 provided that if a citizen of the United States, during any eighteen consecutive month period, is present in a foreign country or countries during at least 510 full days in such period amounts received from sources without the United States, if such amounts constitute earned income, attributable to such period, are to be

excluded from gross income in computing his income tax due the United States.

§ 321 of the Revenue Act of 1951 was added by the Senate Committee. It was not in the bill passed by the House of Representatives. The Senate Committee Report states that § 116(a) as it then provided had two defects. The first was that an individual was denied the exclusion of his first year as a bona fide resident, and the second was that the term "bona fide" resident abroad had been construed quite strictly with the result that many persons who had worked abroad for relatively long periods of time had been unable to meet the "bona fide resident" test. The reasons stated by said Committe for the failure to meet the "bona fide resident" test was (1) the nature of the individual's work, and (2) the individual's presence abroad was for a stated time, such as manager, technicians and skilled workmen who are induced to go abroad for periods of 18 to 36 months. The said Committee stated that it believed that it was particularly desirable to encourage men with technical knowledge to go abroad. The Committee then said:

> "As a result your Committee has added a paragraph to Section 116(a) of the Code providing that income earned abroad by a citizen of the United States who is present in a foreign country or countries for 17 out

> of 18 consecutive months is to be excluded from income . . . ." (Senate Committee Report, United States Code, Congressional and Administration Service, 1951, 82nd Congress--1st Session, Revenue Act of 1951, West Publishing Co.--Edward Thompson Co., p. 3144)."

It is to be noted that for the first time Congress inserted the words "attributable to such period" in § 116(a) (1) "Bona Fide Resident" and used the same words in new 116(a)(2) "Eighteen Months Presence in a Foreign Country". It is believed and submitted that the reason for the use of said words was to overcome the effect of some earlier decisions which held that income received after the termination of the bona fide residence period was not excludable. This reasoning is supported by the Regulations adopted in 1953, (as will be more fully discussed below) wherein it is provided both with respect to the bona fide residence and the 18 months presence that if the taxpayer meets the requirements of either Section, the amounts are excluded irrespective of when received.

Congress next amended § 116(a) by Public Law 287, which became effective August 15, 1953. It is to be noted that the Commissioner of Internal Revenue had not yet amended his regulations to reflect the changes made in § 116(a) by the

Revenue Act of 1951. § 204(a) of Public Law 287 (commonly referred to as Technical Changes Act of 1953) amended § 116(a)(2) by placing a ceiling of $20,000.00 for each taxable year, and a pro rate thereof for a part of a taxable year, on the amount of the excluded income. This is the only change made in said section.

After the enactment of § 204(a) of the Technical Changes Act of 1953, the Commissioner completely rewrote § 29.116-1 of Regulations 111 to reflect the changes made in § 116(a) by both the Revenue Act of 1951 and the Technical Changes Act of 1953. On August 27, 1953, he promulgated T.D. 6039 amending § 29.116-1 of Regulations 111. In both §§ 116-1(a) relating to bona fide residence and 116-1(b) relating to physical presence for 17 of 18 consecutive months, he provided that for amounts which qualified for the respective exclusions, "the amounts shall be excluded from gross income irrespective of when they are received." [Underscoring added]. § 29.116-1(b) later states, "The exclusion granted by Section 116(a)(2) applies to income attributable to any period of 18 consecutive months during which the citizen satisfies the 510 full day requirement. . . ." [Underscoring added]

On September 23, 1953, the Commissioner of Internal Revenue promulgated Regulations 118 which superseded Regulation 111. §§ 39.116-1(a) and (b) of Regulations 118 were

substantially the same as §§ 29.116-1(a) and (b) of Regulations 111 as amended by T.D. 6039, August 27, 1953. Both sections of Regulations 118 contained the provision quoted above relating to the amounts being excluded irrespective of when they are received, and 116-1(b) contained the other above quoted provisions. §§ 39.116-1(a) and 39.116-1(b) remained unchanged until August 14, 1957, when Regulations § 1.911-1 were promulgated by T.D. 6249 under the Internal Revenue Code of 1954. (1961 Prentice-Hall Vol. 1, ¶ 8823.)

The Internal Revenue Code of 1954 re-enacted § 116(a) (1) and (2) of the Internal Revenue Code of 1939 as § 911 (a)(1) and (2), without a single change. (Appendix, infra). At the time of the enactment of the said 1954 Code, Regulations 118, §§ 116-1(a) and (b) were in effect.

Thus, Regulations 118, §§ 116-1(a) and (b) were given the force of law.

> Old Mission Portland Cement Co. v Helvering, 293 U.S. 289, 555 S.Ct. 158, 35-1 U.S.T.C. ¶ 9009;
>
> Massachusetts Mutual Life Insurance Company v United States, 288 U.S. 269, 53 S.Ct. 337, 3 U.S.T.C., ¶ 1045;
>
> B.D. McCaughn, Collector v Hershey Chocolate Co., etc., 283 U.S. 482, 51 S.Ct. 510, 2 U.S.T.C., ¶ 738.

In the latter case, the Supreme Court said:

> "The reenactment of the statute by Congress, as well as, the failure to amend it in the face of the consistent administration construction, is at least persuasive of a legislative recognition and approval of the statute as construed."

In Massachussets Mutual Life Insurance Company v United States, supra, the Supreme Court said:

> "The Congress in the Revenue Acts of 1928 and 1932 reenacted Section 245 without alteration. This action was taken with knowledge of the construction placed upon the Section by the official charged with its administration. If the legislative body had considered the Treasury interpretation erroneously it would have amended the Section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute."

And in Old Mission Portland Cement Company v Helvering, supra, the Supreme Court said:

> "These provisions were retained, without material change, in the regulations promulgated under the 1924, 1926 and 1928 acts . . . as Section 234 (a) (1) to which they pertain has been reenacted in several revenue acts, the regulation now has the force of law." . . . . (citing the McCaughn v Hershey Chocolate Co., and the Massachusetts

Mutual Life Insurance Co. v United States cases, supra .)

Said §§ 116-1 (a) and (b) of Regulations 118 remained in effect until August, 1957, when they were superceded by Regulations §§ 1.911-1(a) and (b). The language "the amounts shall be excluded from gross income irrespective of when they were received" was retained in § 1.911-1 (a) but was deleted from § 1.911-1(b). Although no contrary language was included in § 1.911-1(b) an example was included to indicate that "taxable year" meant year of receipt. (Regulations § 1.911-1 (b)(2)(ii)(c), Appendix, infra). This Regulation was in effect when the Revenue Act of 1962 was enacted. Congress repudiated it and hence it never acquired the force of law. While Congress did not go back to the broad language of §§ 116-1(a) and (b) "irrespective of when received" it did provide for exclusion of amounts received in the taxable year following the year in which the services were performed. § 911 (c)(4) as rewritten by the Revenue Act of 1962 provides:

> "(4) Requirement as to time of receipt.-- No amount received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed may be excluded under subsection (a). (Appendix, infra).

Said subsection (4) applies equally to the bona fide residence exclusion and to the presence abroad exclusion.

It is submitted, therefore, that Congress clearly repudiated year of receipt as the "taxable year" and reestablished year of performance and in addition repudiated in part that time of receipt after the close of the year is material.

III

EACH PETITIONER IS ENTITLED TO SUCH EXCLUSION BY REASON OF BEING HUSBAND AND WIFE DOMICILED IN AND A RESIDENT OF THE STATE OF CALIFORNIA, A COMMUNITY PROPERTY STATE.

Petitioners are husband and wife and residents of and domiciled in the State of California. [R. p. 16] California is a community property state. One-half of the earnings of either spouse vest in and belong one-half to each spouse at the very moment of earning and/or receipt. §§ 164, 163, 162 and 161 (a), Civil Code of California; United States v Malcolm, 282 U.S. 729, 51 S.Ct. 184, 2 U.S.T.C. 650, citing Poe v Seaborn, 282 U.S. 101, 51 S.Ct. 58, 2 U.S.T.C. 611; Goodell v KOCH, 282 U.S. 118, 51 S.Ct. 62; 2 U.S.T.C. 612; Hopkins v Bacon, 282 U.S. 122, 51 S.Ct. 62, 2 U.S.T.C. 613.

The earnings of the husband were never his property, but were the property of the community. Poe v Seaborn,

supra. That being so, the earnings here involved constituted "earned income" of the community. Graham v Commissioner (9th Cir.), 95 Fed. 174, 38-1 U.S.T.C. 9172. The question in the Graham case was whether the wife's community one-half of the income was "earned income". The court, in holding that the wife's community one-half of the earnings did constitute "earned income", said:

> "All of said community income--petitioner's half as well as her husband's half--was 'received as compensation for personal services actually rendered' and was, therefore, within the statutory definition of 'earned income'."

Respondent therein then contended that the phrase "personal services actually rendered" meant rendered by taxpayer. The Court stated:

> "The Board found that said community income was received as compensation for professional services rendered by petitioner's husband. Respondent assumes, erroneously, that these services were rendered by petitioner's husband individually, on his own account and for himself alone, thus assuming as a fact that which, in Washington, is a legal impossibility. When a married man residing in Washington practices a profession or engages in any gainful occupation or activity, he does so

as the agent of a marital community consisting of himself and his wife. Poe v Seaborn, supra. He cannot do so in any other way or in any other capacity. Services rendered by him are actually rendered by the community, that is to say, by him and his wife, equally. So, in this case, petitioner was, no less than her husband, the actual renderer of the services for which they received as compensation the community income above referred to.

"That petitioner did not personally participate in the professional labors of her husband is immaterial. One may actually render a personal service without personally performing the acts constituting the service. Otherwise, a partnership acting through one of its members, or a principal acting through an agent, could not actually render a personal service, the truth being, of course, that such services can be and, in countless instances, are actually so rendered." [Underscoring added].

In Pierce v U.S. (9th Cir.) 254 F. 2d 885, I A.F.T.R. 2d 1498, the Court held that the wife's half of the community income, as well as the husband's half, constituted "business income". The Court said:

"But the warp and woof of community property law in the old community property

> states is that when the husband or the wife is at work, the community is at work; at least, in working, the worker is carrying on the business of the community."

I.T. 3665, 1944 Cumulative Bulletin 161, held that a wife was entitled to exclude her half of the community income derived from sources within a possession of United States where only husband meets the requirements of § 251 of the 1939 Code.

Kaufman v Commissioner, 9 B.T.A. 1180, held that where the income of the husband is exempt from taxation, such income retains its exempt status in the hands of the wife, where the wife is entitled to one-half of the income because of its being the community property.

Rev. Rul. 54-16, I.R.B. 1954-2, 18; 545 C.C.H. 6139 Modified I.T. 3665, supra, by reason of the decisions in Francis v Mullen, 14 T.C. 1179 and Markham v U.S. District Court, Southern District of California, Central Division, June 23, 1953, 53-2 U.S.T.C. 9462. In said ruling, it is said:

> "Under Section 116(a) of the Code income earned by either spouse while a bona fide resident of a foreign country for an uninterrupted period of an entire year or his or her presence in a foreign country for 17 months is exempt as to

> both spouses irrespective of how much or what kind of other income either or both may have." [Underscoring added]

Rev. Rul. 55-246 I.R.B. 1955-18, 7 held that a community property state husband and wife, are each entitled to the exemption under said § 911(a) on their separate returns so long as one of the spouses meets the requirements of either 911(a) (1) or 911 (a)(2), regardless of whether the other spouse meets the specified requirements in § 911(a) of the Code. The ruling states:

> "The division of income on the community property basis does not alter the exempt character of income entitled to exemption under Section 911(a) of the Code. See Rev. Rul. 54-16, C.B. 1954-1, 157."

In Fred MacMurray, 21 T.C. 15, each spouse was entitled to a loss not to exceed $50,000.00 for each of five years under § 130, Internal Revenue Code 1939. Rev. Rul. 54-179, Internal Revenue Bulletin 1954-21, 6, 545 CCH, § 6294, confirmed the holding in the MacMurray case. See also Rev. Rul. 54-178, I.R.B. 1954-21, 5, 545 CCH § 6293, where the spouses are partners to the same effect.

See also Technical Amendments Bill of 1958 (H.R. 8381) where in § 2 of the House bill, it was proposed to limit the

retirement income credit to the spouse in a community property state who individually performed the services and in the Senate bill it was proposed to put noncommunity property States on the same basis as community property states by treating earned income of a spouse as having been earned half by each spouse. This proposed amendment was killed in conference. Thus, both Houses recognized that spouses in community property states each received the retirement income credit by reason of the income being community property.

From the foregoing, it is inescapable and unanswerable that each petitioner is entitled to the exclusion under the provisions of § 911(a)(2) Internal Revenue Code 1954.

The identical arguments, authorities and citations contained herein were presented in the brief filed with the Tax Court. But the Tax Court ignored all of the citations and authorities set forth in said brief, except Rev. Rul. 55-246, 1955-1 C.B. 92. The Tax Court held said ruling inapplicable because (1) separate returns were involved in the ruling, while a joint return was filed by the Renoirs, and (2) because the limitation applies to income, not to the individual taxpayer. The Tax Court does not indicate or mention why the law should differ when a joint return is filed and when separate returns are filed. There is no difference. It is well known that joint returns were permitted so as to give non-community property taxpayers the same "break" that

community property taxpayers were enjoying. The introduction of joint returns was not intended, and indeed did not, make one set of tax rules applicable to them and another set of tax rules applicable to separate returns. There is nothing in either the law or the regulations to justify such distinction. While it is true, as the Tax Court said, the limitation applies to the income, not to individual taxpayers, the court completely overlooks the fact that the community income belongs one-half to each. This being true, the exclusion applies to the income of each spouse. Equally important is that the Tax Court ignored the reference in Rev. Rul. 55-246 to Rev. Rul. 54-16.

Finally, on this point, the Tax Court states petitioner's interpretation would favor taxpayers in community property states and that without a clear-cut statutory mandate, the Court would not attribute to the Congress an intention to authorize a double exclusion of such income for taxpayers in community property states as compared with other taxpayers. Congress in the <u>Revenue Act of 1962</u> has now given a clear-cut statutory mandate for years ended prior to the effective date of the amendment of § 911. § 911(c)(3) of said Act reads:

> "(3) <u>Treatment of community income</u>.
> - - In applying paragraph (1) with respect
> to amounts received for services performed
> by a husband

> or wife which are community income under community property laws applicable to such income, the aggregate amount excludable under subsection (a) from the gross income of such husband and wife shall equal the amount which would be excludable if such amounts did not constitute such community income." (Appendix, infra).

The amendments made to § 911 by the Revenue Act of 1962 apply to years ending after September 4, 1962, with certain exceptions not here applicable. (§ 11 (c)(1) of Public Law 87-834, Oct. 16, 1962, Appendix infra.)

CONCLUSION

In conclusion, it is submitted that the Tax Court of the United States erred in holding that "taxable year" as used in § 911(a)(2) of the Internal Revenue Code of 1954 means year of receipt; in failing to hold that "taxable year" means the year in which the services were performed; in determining that the income received by petitioners in 1956 and 1957 attributable to services performed during a period when petitioners qualified under said § 911 (a)(2) as being physically present in foreign countries for a period of more than 510 full days in an 18 consecutive

month period is taxable to them in 1956 and 1957; and in failing to determine that each petitioner is entitled to the exclusion provided in said § 911(a)(2) by reason of said income being the community income of petitioners under the law of the State of California.

Respectfully submitted,

J. EVERETT BLUM

Attorney for Petitioners.

CERTIFICATE RE RULES 18 AND 19

I, J. EVERETT BLUM, the attorney for petitioners, certify that I have examined Rules 18 and 19, as amended, and in my opinion, the foregoing Brief conforms to all requirements of said Rules, as amended.

/S/ J. EVERETT BLUM

APPENDIX

STATUTES AND REGULATIONS INVOLVED.

The following statutes are involved herein:

Internal Revenue Code of 1939:

Section 116(a) as amended by the Revenue Act of 1951:

"Sec. 116. Exclusions from Gross Income:

In addition to the items specified in Section 22(b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(a) Earned Income from Sources without the United States.—

(1) Bona fide resident of foreign country.—

In the case of an individual citizen of the United States, who establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts constitute earned income (as defined in paragraph (3)) attributable to such period; but such individual shall not be allowed as a deduction from his gross

income any deductions properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

(2) Presence in foreign country for 17 months. —— In the case of an individual citizen of the United States, who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts constitute earned income (as defined in paragraph (3)) attributable to such period; but such individual shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

(3) Definition of earned income.—For the purposes of this subsection 'earned income' means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of

a taxpayer engaged in a trade or business in which both personal services and capital are material income producing factors, under regulations prescribed by the Commissioner with the approval of the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 20 per centum of his share of the net profits of such trade or business, shall be considered as earned income."

Section 116 as amended by the Revenue Act of 1951 and Section 204(a) Public Law 287 (Technical Changes Act of 1953).

"I. R. C., Sec. 116. Exclusions from Gross Income.

In addition to the items specified in section 22 (b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(a) Earned Income from Sources without the United States.—

(1) Bona fide resident of foreign country.—In the case of an individual citizen of the United States, who establishes to the satisfaction of the Secretary that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an

entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts constitute earned income (as defined in paragraph (3))attributable to such period; but such individual shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

(2) Presence in foreign country for 17 months.—In the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (Except amounts paid by the United States or any agency thereof) if such amounts constitute earned income (as defined in paragraph (3)) attributable to such period; but such individual shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

<u>If the 18 months period includes the entire taxable year, the amount excluded under this paragraph for such taxable year</u>

<u>shall not exceed $20,000</u>. <u>If the 18 month period does not include the entire taxable year, the amount excluded under this paragraph for such taxable year shall not exceed an amount which bears the same ratio to $20,000 as the number of days in the part of the taxable year within the 18 month period bears to the total number of days in such year</u>.

(3) Definition of earned income.—For the purposes of this subsection, 'earned income' means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income producing factors, under regulations prescribed by the Commissioner with the approval of the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess

of 20 per centum of his share of the net earned profits of such trade or business, shall be considered as earned income."

[Underscored words added by Public Law 287.]

Internal Revenue Code of 1954:

"Sec. 911. Earned Income from Sources Without the United States.

(a) General Rule.——The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) Bona fide resident of foreign country.——In the case of an individual citizen of the United States, who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts constitute earned income (as defined in subsection (b)) attributable to such period; but such individual shall not be allowed as a deduction from his gross income any deductions (other than those allowed by section 151, relating to personal exemptions) properly

allocable to or chargeable against amounts excluded from gross income under this paragraph.

(2) Presence in foreign country for 17 months.——In the case of an individual citizen of the United States, who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or an agency thereof) if such amounts constitute earned income (as defined in subsection (b) attributable to such period; but such individual shall not be allowed as a deduction from his gross income any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this paragraph. If the 18-month period includes the entire taxable year, the amount excluded under this paragraph for such taxable year shall not exceed $20,000. If the 18-month period does not include the entire taxable year, the amount excluded under this paragraph for such taxable year shall not exceed an amount which bears the same ratio to $20,000 as the number of days in the part of the taxable year within the 18-month

period bears to the total number of days in such year.

(b) Definition of Earned Income.—For purposes of this section, the term 'earned income' means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary or his delegate, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income."

SEC. 7701 DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof --

* * * * *

(23) Taxable year. -- The Term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the taxable income is computed under subtitle A. * * *

SEC. 911 as amended by the Revenue Act of 1962 insofar as applicable herein:

Sec. 911. Earned Income From Sources Without the United States.

(a) General Rule. -- The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) Bona fide resident of foreign country. --In the case of an individual citizen of the United States who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterruppted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such uninterrupted

period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

(2) Presence in foreign country for 17 months.--In the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or an agency thereof) which constitute earned income attributable to services performed during such 18-month period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

An individual shall not be allowed, as a deduction from his gross income, any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this subsection.

* *

(c) Special Rules.-- For purposes of computing the amount excludable under subsection (a), the following rules shall apply:

(1) Limitations on amount of exclusion.-- The amount excluded from the gross income of an individual under subsection (a) for any taxable year shall not exceed an amount which shall be computed on a daily basis at an annual rate of --

(A) except as provided in subparagraph (B), $20,000 in the case of an individual who qualifies under subsection (a), or

(B) $35,000 in the case of an individual who qualifies under subsection (a)(1), but only with respect to that portion of such taxable year occurring after such individual has been a bona fide resident of a foreign country or countries for an uninterrupted period of 3 consecutive years.

(2) Attribution to year in which services are performed.--For purposes of applying paragraph (1), amounts received shall be considered received in the taxable year in which the services to which the amounts are attributable are performed.

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(3) Treatment of community income.--In applying paragraph (1) with respect to amounts received from services performed by a husband or wife which are community income under community property laws applicable to such income, the aggregate amount excludable under subsection (a) from the gross income of such husband and wife shall equal the amount which would be excludable if such amounts did not constitute such community income.

(4) Requirement as to time of receipt.--No amount received after the close of the taxable year following the taxable year, in which the services to which the amounts are attributable are performed may be excluded under subsection (a)."

[Underscored words added by Revenue Act of 1962]

Sec. 11 (c), Revenue Act of 1962:

Effective date--Applies to taxable years ending after September 4, 1962, but only to amounts (a) received after March 12, 1962, and attributable to services performed after December 31, 1962, or (b), received after December 31, 1962, and attributable to services performed on or before December 31, 1962

unless on March 12, 1962, there existed a right (whether forfeitable or nonforfeitable) to receive such amounts.

Regulations 118, Section 39.116-1(a) and (b) (insofar as applicable):

"Reg. 118, Sec. 39.116-1. Earned Income From Sources without the United States —(a) Resident of a foreign country. (1) Amounts constituting earned income as defined in section 116(a)(3) shall be excluded from gross income in the case of an individual citizen of the United States who establishes to the satisfaction of the Commissioner that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, if such amounts are (i) from sources without the United States, (ii) attributable to such uninterrupted period, and (iii) not paid by the United States or any agency or instrumentality thereof. The exemption from tax thus provided is applicable to such amounts as are attributable to that portion of an uninterrupted period of bona fide foreign residence which falls within a taxable year during the course of which the citizen begins or terminates bona fide residence in a foreign country, provided that such period includes at least one entire taxable year. If attributable to an uninterrupted period in respect of which the

citizen qualifies for the exemption from tax thus provided, the amounts shall be excluded from gross income irrespective of when they are received. The period during which the citizen was a bona fide resident of a foreign country or countries prior to the commencement of his first taxable year beginning after December 31, 1951, may be taken into account in determining whether such citizen has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year."

"(b) Presence in a foreign country. (1) Amounts constituting earned income as defined in section 116(a)(3) shall be excluded from gross income in the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or countries during a total of at least 510 full days, if such amounts are (i) from sources without the United States, (ii) attributable to such period, and (iii) not paid by the United States or any agency or instrumentality thereof. If attributable to a period of 18 consecutive months in respect of which the citizen qualifies for the exemption from tax thus provided, the amounts shall be excluded from gross income irrespective of when they are received.

(2) For taxable years ending before January 1, 1953, there is no limitation upon the amount which may be excluded from gross

income pursuant to subparagraph (1). For taxable years ending after December 31, 1952, but only with respect to amounts received after such date, the amount excluded from gross income under the provisions of section 116(a)(2) shall not exceed $20,000 if the 18-month period includes the entire taxable year. If the 18-month period does not include the entire taxable year, the amount excluded from gross income under such section for such taxable year shall not exceed an amount which bears the same ratio to $20,000 as the number of days in the part of the taxable year within the 18-month period bears to the total number of days in such year. In the case of a fiscal year beginning in 1952 and ending in 1953 the exclusion of amounts received after December 31, 1952, shall not exceed the lesser of the amount determined under the two preceding sentences or an amount which is the same proportion of $20,000 as the number of days in such taxable year after such date is of 365 days. There is no limitation as to the total amount of the exclusion for amounts received prior to January 1, 1953, in the case of such a fiscal year."

Regulations, Section 1.911-1(a) and (b) under the Internal Revenue Code of 1954 (insofar as applicable):

"(a) Bona fide resident of a foreign country — (1) Qualifications for exemption. Amounts constituting earned income as defined in section 911(b) shall be excluded from the

gross income of an individual citizen of the United States who establishes to the satisfaction of the Commissioner that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, if such amounts are (i) from sources without the United States, (ii) attributable to such uninterrupted period, and (iii) not paid by the United States or any agency or instrumentality thereof. The exemption from tax thus provided is applicable to such amounts as are attributable to that portion of an uninterrupted period of bona fide foreign residence which falls within a taxable year during which the citizen begins or terminates bona fide residence in a foreign country, provided that such period includes at least one entire taxable year. If attributable to an uninterrupted period in respect of which the citizen qualifies for the exemption from tax thus provided, the amounts shall be excluded from gross income irrespective of when they are received.

(b) Presence in a foreign country — (1) Qualifications for excemption. Subject to the limitations in subparagraph (2), amounts constituting earned income as defined in section 911(b) shall be excluded from gross income in the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or countries during a total of at least 510 full days, if such amounts are (i)

from sources without the United States, (ii) attributable to such period and (iii) not paid by the United States or any agency or instrumentality thereof. For purposes of determining the right to the exclusion under section 911(a)(2) for a taxable year to which the Internal Revenue Code of 1954 is applicable, the period of presence in a foreign country may include a period prior to the beginning of such taxable year, even though the tax for such prior period is computed under the Internal Revenue Code of 1939. For example, the qualifying period may, in the case of a taxpayer who makes his return on the calendar year basis, cover the period from July 1, 1953, to December 31, 1954, for purposes of the exclusion allowed under section 911 (a)(2) for the taxable year 1954.

(2) Amount of exemption. (i) The amount excluded from gross income under the provisions of section 911 (a)(2) shall not exceed $20,000 if the 18-month period includes the entire taxable year. If the 18-month period does not include the entire taxable year, the amount excluded from gross income under such section for such taxable year shall not exceed an amount which bears the same ratio to $20,000 as the number of days in the part of the taxable year within the 18-month period bears to the total number of days in such year."

(ii) The application of subdivision (i) of this subparagraph may be illustrated by the

following example:

Example. — A, a citizen of the United States who files his returns for the calendar year using a cash receipts and disbursements method, was privately employed and physically present in France from January 1, 1953, through July 15, 1955. On December 31, 1953, he received compensation in the amount of $20,000 for the services rendered by him during 1953. He left France on July 16, 1955, and returned to the United States. On August 1, 1955, he received $30,000, part of which was for the services rendered by him during 1954 and the balance of which was for his services rendered during the period January 1, 1955, through July 15, 1955. On January 15, 1956, A received an additional $10,000 for the services rendered by him during 1954.

(a) Since the $20,000 compensation received by A on December 31, 1953, was attributable to an 18-month period during at least 510 full days of which he was present in a foreign country, and since that 18-month period included his entire taxable year 1953, the entire $20,000 is exempt from taxation.

(b) Only $12,712.33 (232/365 X $20,000) of the $30,000 received by A on August 1, 1955, is exempt from taxation since only 232 days of his taxable year 1955 is included within such an 18-month period. The number of days (232) is determined by treating the first day of the 18-month period as coinciding with the

first day of the 510-day period ending July 15, 1955 (the last full day A was present in France), was February 21, 1954. Commencing with February 21, 1954, the 18-month period ends August 20, 1955. The number of days in that part of 1955 falling within the 18-month period is, therefore, 232 (January 1, 1955, through August 20, 1955). The amount excludable by A in 1955 ($12,732.33) is computed on the basis of the following formula:

$$\frac{\text{Number of days in that part of the taxable year falling within the 18-month period}}{\text{Number of days in the taxable year}} \times$$

$20,000 (Maximum amount excludable for an entire taxable year under section 911 (a)(2), or 232/365 x $20,000.

(c) None of the $10,000 attributable to the services rendered by A during 1954 but received by him in 1956 is exempt from taxation because no part of his taxable year 1956 is included within 18-month period. For the definition of "taxable year" see section 7701(a)(23).

* * * * * * * *

<u>Rev. Rul. 54-72, 1954-1 Cum. Bull. 117:</u>

Where a taxpayer meets the requirements of section 116 (a)(2) of the Internal Revenue Code regarding

presence in a foreign country or countries during at least 510 full days during any period of 18 consecutive months, but receives compensation attributable to such period in a taxable year ending subsequent to December 31, 1952, no portion of which falls within the 18-month period, no portion of such compensation received in such taxable year is excludable from his gross income.

Advice is requested as to the application of section 116 (a)(2) of the Internal Revenue Code (as amended by sec. 204 of the Technical Changes Act of 1953. Public Law 287, 83d Cong. C.B. 1953-2, 485) and Regulations 118 as amended by Treasury Decision 6039, C.B. 1953-2, 162, with respect to amounts received after December 31, 1952, attributable to earned income from sources outside the United States under the following circumstances:

Taxpayer worked abroad and met the requirements of section 116(a)(2) of the Internal Revenue Code regarding presence in a foreign country or countries during at least 510 full days during a period of 18 consecutive months. He returned to the United States at the end of 1952. In his taxable year 1953, no part of which fell within the 18 month period, he received compensation attributable to such period in the amount of $10,000.

Section 39.116-1(b) of Regulations 118, as amended by T. D. 6039, supra, which is applicable to amounts constituting earned income as defined by section 116(a)(3) of the Code, from sources outside the United States, provides in part as follows:

> (1) Amounts constituting earned income as defined in Section 116(a)(3) shall be excluded from gross income in the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or countries during a total of at least 510 full days, if such amounts are (i) from sources without the United States, (ii) attributable to such period, and (iii) not paid by the United States or any agency or instrumentality thereof. If attributable to a period of 18 consecutive months in respect of which the citizen qualifies for the exemption from tax thus provided, the amounts shall be excluded from gross income irrespective of when they are received.
>
> (2) For taxable years ending before January 1, 1953, there is no limitation upon the amount which may be excluded from gross income pursuant to subparagraph (1). For taxable

> years ending after December 31, 1952, but only with respect to amounts received after such date, the amount excluded from gross income under the provisions of section 116 (a)(2) shall not exceed $20,000 if the 18-month period includes the entire taxable year. If the 18-month period does not include the entire taxable year, the amount excluded from gross income under such section for such taxable year shall not exceed an amount which bears the same ratio to $20,000 as the number of days in the part of the taxable year within the 18-month period bears to the total number of days in such year * * *

Subparagraph (1) quoted above is subject to the facts in the instant case, subparagraph (1) of the regulations quoted above, standing alone, indicates that the $10,000 would be excluded from gross income since it is earned income from sources outside the United States and is attributable to a period of 18 consecutive months during which the taxpayer was present in a foreign country for at least 510 full days. However, since no part of the taxable year in which the $10,000 was received falls within the 18-month qualifying period, the application of the limitation set forth in subparagraph (2) results in a figure of zero and no portion of the

$10,000 received in 1953, even though attributable to the qualifying period, is excludable from gross income.

The formula for such computation may be stated as follows, but refers only to taxable years ending after December 31, 1952, and only with respect to amounts received after such date:

$$\frac{\text{Number of days in that part of the taxable year of receipt falling within the 18-month period}}{\text{Number of days in the taxable year of receipt}} \times \$20{,}000 = \text{Maximum amount excludable.}$$

Application of the above formula to the facts in this case is illustrated as follows:

$$\frac{0}{365} \times \$20{,}000 = \text{Zero} = \text{Maximum amount excludable}$$

In view of the foregoing, it is held that where a taxpayer meets the requirements of section 116 (a)(2) of the Internal Revenue Code regarding presence in a foreign country or countries during at least 510 full days during any period of 18 consecutive months, but receives compensation attributable to such period in a taxable year ending subsequent to December 31, 1952, no portion of which falls within the 18-month period, no portion of such compensation received in such taxable year is excludable from his gross income.